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No. _____

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

BANKERS TRUST NEW YORK CORPORATION AND CONSOLIDATED SUBSIDIARIES,

Petitioners,

—v—

DEPARTMENT OF FINANCE OF THE CITY OF NEW YORK AND COMMISSIONER OF FINANCE OF THE CITY OF NEW YORK,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether New York City may impose an income-based tax on petitioners' interest income from debt obligations of the United States, in light of the federal statute exempting federal securities from state and local taxation and the Supremacy Clause of the Constitution?

PARTIES TO THE PROCEEDING

Petitioners are Bankers Trust New York Corporation,* a bank holding company incorporated in New York and its subsidiaries included in a consolidated New York City tax return for the taxable year in issue (1976). However, only Bankers Trust New York Corporation and its wholly owned subsidiary, Bankers Trust Company, a New York commercial bank and trust corporation, have an interest in this proceeding because none of the other consolidated subsidiaries held debt obligations of the United States in 1976.

Respondents are the Department of Finance of the City of New York, which administers the New York City tax in controversy, and its head officer, the Commissioner of Finance of the City of New York.

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* *Rule 29.1 List.*—Subsidiaries (except wholly-owned) of the parent corporation, Bankers Trust New York Corporation, are: Administradora de Fondos de Pensiones Provida S.A., ADS Associates, Inc., BT Caribe, BT Lippo Leasing, Compania de Seguros de Vida Consorcio Nacional de Seguros S.A., I.M. Trust, PT BT Prima Securities Indonesia Ltd., Tenedor de Valores del Pacifico Ltd., Thai Investments & Securities Co. Ltd., Tun Thamrong Co. Ltd., World Markets Co. GMBH. None of the foregoing subsidiaries is involved in the present case.

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PETITION FOR WRIT OF CERTIORARI TO THE
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PETITION FOR WRIT OF CERTIORARI

PRIOR OPINIONS

Opinions delivered in this case by other courts or administrative agencies are:

Opinion of the New York Court of Appeals (1a)[1], 79 N.Y.2d 457 (1992);

Opinion of the Supreme Court of New York, Appellate Division, First Department (13a), 171 A.D.2d 550, 567 N.Y.S.2d 438 (1st Dept. 1991);

Decision of the New York City Department of Finance, Bureau of Hearings, Finance Hearing Decision No. 274 (19a),

1 Parenthetical reference is to the appendix hereto.

CCH N.Y. State Tax Rep., ¶ 400-314f (June 6, 1990) (N.Y. City—New Matters).

JURISDICTION OF THIS COURT

On May 12, 1992, the New York Court of Appeals (the highest court of the State) entered its judgment affirming the judgment of the New York Supreme Court, Appellate Division, First Department, which had confirmed the determination of the Department of Finance denying in full petitioners' claim for tax refund. No rehearing nor extension of time to file a petition for a writ of certiorari was requested by petitioners. Accordingly, the time to file a petition expires on August 10, 1992.

Jurisdiction of this Court is pursuant to 28 U.S.C. § 1257, which provides for review by writ of certiorari of a final judgment of the highest court of a State where the validity of a state (or local[2]) law is drawn in question on the ground of its being repugnant to the Constitution or statutes of the United States or where a right, privilege or immunity is claimed under a federal statute. (Under the pre-1988 version of 28 U.S.C. § 1257, clause (2) thereof would have permitted an appeal to this Court because the state court decided in favor of validity of the local law.)

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2 *See Erznoznik* v. *Jacksonville*, 422 U.S. 205, 207, n.3 (1975).

STATUTES INVOLVED

1. Federal (as in effect in 1976[3])—

Rev. Stat. § 3701, 31 U.S.C. § 742:

> [A]ll stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

2. New York City (as in effect in 1976[4])—

N.Y.C. Admin. Code, § R46-37.1(a):

> § R46-37.1. Imposition of tax.—(a) For the privilege of doing business in the city in a corporate or organized capacity, a tax, computed under section R46-37.5, is hereby annually imposed on every banking corporation for

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3 In 1982 the quoted provision was codified as 31 U.S.C. § 3124(a), as follows:

> (a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except—
>
> (1) a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation; and
>
> (2) an estate or inheritance tax.

The House Report (Judiciary Committee) stated that no substantive change was intended by this codification. H.R. Rep. No. 97-651, 97th Cong., 2d Sess. 1, 3 (1982), *reprinted in* 1982 U.S. Code Cong. & Ad. News 1895. Accord, *American Bank & Trust Co. v. Dallas Co.*, 463 U.S. 855, 859, n.1, reh'g denied, 463 U.S. 1250 (1983).

4 In 1986, the New York City Administrative Code was recodified. The quoted provisions were redesignated as sections 11-639, 11-641, and 11-643.3, respectively, without change material to this case.

each of its taxable years, or any part thereof, beginning on or after January first, nineteen hundred seventy-three.

N.Y.C. Admin. Code, § R46-37.3:

§ R46-37.3. Computations of entire net income.—(a) Entire net income means total net income from all sources which shall be the same as the entire taxable income which the taxpayer is required to report to the United States treasury department, except as hereinafter provided.

(b) Entire net income shall be computed without the deduction or exclusion of:

(1) any part of any income from dividends or interest on any kind of stock, securities or indebtedness,

* * *

N.Y.C. Admin. Code, § R46-37.5.3:

§ R46-37.5.3. Computation of tax for taxable years beginning on or after January first, nineteen hundred seventy-five.—For taxable years beginning on or after January first, nineteen hundred seventy-five, the tax imposed by section R46-37.1 shall be the greater of the following computations:

(a) Basic tax. (1) Except for a savings bank and savings and loan association, thirteen and eight hundred twenty-three one-thousandths per cent of the taxpayer's entire net income, or the portion thereof allocated to this city, for the taxable year, or part thereof.

* * *

STATEMENT OF THE CASE

A. Facts

Bankers Trust New York Corporation is now and was in 1976 a bank holding company incorporated under the laws of the State of New York. Its principal subsidiary, Bankers Trust

Company, is a commercial bank and trust company incorporated under the banking laws of the State of New York. Both have their principal offices in New York City. This proceeding involves the 1976 New York City Financial Corporation Tax liability of both Bankers Trust New York Corporation and Bankers Trust Company (hereinafter, "petitioners"), which filed a consolidated City Financial Corporation Tax return for that year (including other affiliated corporations which are not involved in this proceeding because they had no income from United States obligations in 1976).

In 1976, both petitioners held substantial amounts of debt obligations of the United States as investments, and, in addition, Bankers Trust Company was a dealer in such obligations and held substantial amounts of such obligations in inventory. Together, petitioners received interest income in 1976 on obligations of the United States in the amount of $39,134,000 and on obligations of agencies of the United States in the amount of $8,567,000, aggregating $47,701,000 (rounded). Such amounts were included in full in petitioners' consolidated New York City Financial Corporation Tax return for 1976, as expressly required by the City tax ordinance (N.Y.C. Admin. Code, § R46-37.3(b)), and subjected to such tax at the rate of 13.823 percent (N.Y.C. Admin. Code, § R46-37.5.3(a)(1)). This City tax, payable to and administered by the City Commissioner of Finance (*e.g.*, N.Y.C. Admin. Code, § R46-37.9 (now § 11-647)), is applicable only within the City and not elsewhere in New York State.

It is petitioners' position that such interest income on obligations of the United States was erroneously and improperly required to be included in income subject to the Financial Corporation Tax and should have been excluded by reason of the federal statute which prohibits states and their political subdivisions from taxing interest on such obligations, resulting in petitioners' entitlement to their claimed tax refund. Respondents contend that such income from United States obligations is subject to the Financial Corporation Tax because of an

exception in the federal statute for "franchise or other non-property taxes in lieu thereof imposed on corporations."

B. Proceedings Below

This proceeding was commenced by the filing by petitioners of a timely claim for tax refund for 1976, in which they asserted that they "erroneously included interest income in the amount of $47,701,718 from obligations of the United States . . .", citing "31 USC § 742 as revised, 31 USC § 3124(a)." This claim was fully denied by the City, and petitioners, following the appeal procedures provided by City law, filed a timely petition for an administrative hearing, again asserting that it had erroneously included interest income from obligations of the United States and citing the relevant federal statute. Following a hearing held before a hearing officer of the Department of Finance, the Department again denied the refund in a decision discussing and rejecting petitioners' claim for exemption under federal law (19a-28a).

Under New York law, petitioners had the right to seek review of the adverse final administrative determination of respondents in the courts and petitioners filed a timely petition for such review in the Supreme Court for New York County, the appropriate court of first instance, again raising the federal exemption issue. The New York Civil Practice Law and Rules (sections 7803(4) and 7804(g)) provided that a case such as this (involving an administrative hearing determination) could be transferred directly to the intermediate appellate court, the Appellate Division, First Department; and, by stipulation of the parties, the case was so transferred (15a-16a). The Appellate Division, after briefing and oral argument, confirmed respondents' determination in a decision and order concluding that the City tax fell within the franchise tax exception of Rev. Stat. § 3701 (13a-14a).

Petitioners sought to appeal this decision to the State's highest appellate court, the Court of Appeals, but that Court dismissed the appeal on the ground that "no substantial constitutional question is directly involved" (11a-12a). Peti-

tioners thereupon duly and timely sought leave to appeal (akin to certiorari) and leave was granted by the Court of Appeals (9a-10a). That Court, following briefing and oral argument, affirmed the judgment of the Appellate Division on the same ground, that the franchise tax exception of Rev. Stat. § 3701 was applicable (1a-6a).

At all administrative and judicial levels, petitioners asserted their claim for exclusion from City taxation of the interest on federal obligations under Rev. Stat. § 3701 (which was the only issue raised by petitioners) and this issue was fully considered at all such levels, as described above and reflected in the cited opinions.

REASONS FOR ALLOWANCE OF THE WRIT

A. This Case Involves an Important Question of Federal Law Which Has Not Been, But Should Be, Settled by this Court.

One of the earliest established and fundamental principles of federalism is the doctrine of intergovernmental tax immunity. In 1819, this Court's landmark opinion, *M'Culloch* v. *Maryland*, 17 U.S. (4 Wheat) 316 (1819), formulated the basic concept of federal immunity from state and local taxation; and in 1829 this tax immunity was extended, by *Weston* v. *City Council of Charleston*, 27 U.S. (2 Pet) 449 (1829), to private persons holding federal obligations. Initially, the immunity of federal obligations from state and local taxation was principally based on the Borrowing Clause of the Constitution (Art. I, § 8, Cl. 2), Chief Justice Marshall stating:

> Can any thing be more dangerous, or more injurious, than the admission of a principle which authorizes every state and every corporation in the union which possesses the right of taxation, to burthen the exercise of this [federal borrowing] power at their discretion? 27 U.S. (2 Pet) at 465-466.

More recently, this Court has suggested in dictum, in *South Carolina* v. *Baker*, 485 U.S. 505, 523, 526 (1988), that the tax exemption of private persons must now be based on federal statutory mandate and the Supremacy Clause (Art. VI, Cl. 2).

The statutory exemption of federal obligations from state and local taxation is also of long standing, the predecessor of Rev. Stat. § 3701 having been enacted 130 years ago. Act of Feb. 25, 1862, Ch. 33, § 2, 12 Stat. 346. The federal statute was substantially strengthened in 1959 by the addition of its second sentence, to make clear that formal distinctions, such as between taxes *on* income and taxes *measured by* income, would no longer be valid. S. Rep. No. 909, 86th Cong. 1st Sess. 8 (1959); H.R. Rep. No. 1148, 86th Cong., 1st Sess. 12 (1959).

The second sentence of Rev. Stat. § 3701 has two parts: first, a very broad and inclusive prohibition against direct or indirect consideration of federal obligations or interest thereon in computing a state or local tax; and second, a very narrow exception for, in the words of the most recent codification, "a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation." It is undeniable that the City tax in controversy violates the first part. The narrow question in the present case, therefore, is whether a tax imposed by a city which has no corporate franchising power or authority qualifies (or can qualify) as a "franchise tax"[5] within the meaning of the exception in the second part.

During the 130 years between the *Weston* decision in 1829 and the 1959 amendment to Rev. Stat. § 3701, this Court has considered over 30 cases involving the exclusion of federal obligations from state and local taxation (see cases outlined at

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5 Both courts below based their opinions on the proposition that the New York City tax "functions" as a franchise tax. The statutory alternative of "another nonproperty tax instead of a franchise tax" was not relied upon by either court, and is clearly inapplicable since New York State already imposes a franchise tax on the same federal interest at the rate (in 1976) of 12%. N.Y. Tax L. § 1451. See *Western Air Lines, Inc.* v. *Board of Equalization*, 480 U.S. 123, 132 (1987) (an "in lieu tax" applies "to the exclusion of any other tax . . . .").

29a-33a), but has never held that, or even had occasion to determine whether, a city tax can qualify for exception from this exclusion on the theory that it is a franchise tax. The present petitioners previously raised this issue in an appeal to this Court involving a different taxable year, but respondents asserted that the issue had been untimely raised in the context of a proceeding involving other issues and this Court dismissed the appeal "for want of properly presented federal question." *Bankers Trust New York Corp.* v. *Department of Finance*, 481 U.S. 1034 (1987). The present case squarely and properly presents to this Court this very important federal question, involving the imposition on federal interest of a City "business" tax of 13.823%, in addition to (and not "in lieu of" or "instead of") a State franchise tax on the same interest of 12%.

B. The Opinions of the New York Courts Conflict with a Long Line of Supreme Court Precedents Defining the Franchise Tax Exception From Rev. Stat. § 3701 Before Its 1959 Amendment, and with the Supreme Court's Interpretation of the Current Statute.

(1) Pre-1959 Law

As indicated above, during the 130 years between the *Weston* case and the 1959 amendment of Rev. Stat. § 3701, there was much litigation over the scope of the tax immunity of federal obligations (see 29a-33a), and the exemption was narrowed by judicial interpretation. The Supreme Court allowed *states*, which had authority over the franchising of corporations, to impose corporate franchise taxes that included in their measure federal obligations or interest thereon. *E.g.*, *Werner Machine Co.* v. *Director*, 350 U.S. 492 (1956); *Educational Films Corp.* v. *Ward*, 282 U.S. 379 (1931). The Supreme Court also held that a few other types of state taxes could include federal obligations in their measure. *E.g.*, *Van Allen* v. *The Assessors*, 70 U.S. (3 Wall) 573 (1866) (bank shares tax); *Plummer* v. *Coler*, 178 U.S. 115 (1900) (inheritance tax).

During this 130-year period, however, there was not one case in which a municipality was held under any theory to qualify for exception from the federal tax immunity doctrine. The only cases in which the Supreme Court allowed franchise taxes to be applied to United States obligations were ones involving states, which, of course, do have corporate franchising authority. The Court's rationale for allowing franchise taxes, as explained in *Home Insurance Co.* v. *New York*, 134 U.S. 594, 599-600 (1890), was:

> "The right or privilege to be a corporation, or to do business as such body, is one generally deemed of value to the corporators, or it would not be sought in such numbers as at present. It is a right or privilege by which several individuals may unite themselves under a common name and act as a single person, with a succession of members, without dissolution or suspension of business and with a limited individual liability. The granting of such right or privilege rests entirely in the discretion of the State, and, of course, when granted, may be accompanied with such conditions as its legislature may judge most befitting to its interests and policy. It may require, as a condition of the grant of the franchise, and also of its continued exercise, that the corporation pay a specific sum to the State each year, or month, or a specific portion of its gross receipts, or of the profits of its business, or a sum to be ascertained in any convenient mode which it may prescribe."

It is important to note that a key element of this rationale is that there is a grant of a valuable right involved (the grant or continued exercise of the franchise) which the state has discretion to withhold and, therefore, to make a charge for. This element cannot be introduced merely by including in a taxing law talismanic language regarding privilege. For example, where a state sought to avoid the federal immunity by designating a tax as a tax on the privilege of doing business, but was really seeking to reach federal obligations, the tax was held inapplicable to federal obligations. *MacAllen Co.* v. *Massachusetts*, 279 U.S. 620 (1929). The Court stated:

> "If, by varying the form,—that is to say, if, by using one name for a tax instead of another, or imposing a tax in terms upon one subject when another is in reality aimed at,—the substance and effect of the imposition may be changed, constitutional limitations upon powers of taxation would come to naught. The rule is otherwise." 279 U.S. at 626.

See also, Pacific Co. v. *Johnson*, 285 U.S. 480, 490 (1932) ("The distinction is one of substance, not of form . . . ."); *Missouri ex rel Missouri Ins. Co.* v. *Gehner*, 281 U.S. 313, 321 (1930) ("Neither ingenuity in calculation nor form of words in state enactments can deprive the owner of the tax exemption established for the benefit of the United States.").

In the present case, the City does not have legal authority over the doing of business in the City by a bank or other corporation. Only the state has such authority. See N.Y. Const., Art X, § 1; N.Y. Bus. Corp. L., § 102(4), (7); N.Y. Bank. L., §§ 24, 200. Once the state has granted such authority, the bank or other corporation may freely do business in New York City without any City approval relating to its corporate status.

It may be a privilege for a corporation to do business in New York City, in the same sense that it may be considered a privilege for an unincorporated business or an individual to do business in the City (or even to reside in the City). These connections with the City provide the City with a nexus to impose a tax on the person, but such tax is not a "franchise" tax as the Supreme Court has visualized such a tax because the "privilege" of doing business in the City is not (with possible exceptions not relevant here) conditioned on City approval or grant.

Nevertheless, both courts below emphasized the inclusion of 15 words in the City tax law, "for the privilege of doing business in the City in a corporate or organized capacity"[6] as suf-

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6 It is noteworthy that the State statute authorizing the City tax (*all* City taxes must be so authorized, N.Y. Const., Art. XVI, § 1) omits the last six of the 15 words, "in a corporate or organized capacity." See N.Y. General City Law, Model Local Law, § 12, App., p. 489 (McKinney's).

ficient to convert the tax from an income to a franchise tax (6a, 14a), without regard to whether this language had any material legal significance in the case of a municipal tax other than to afford a basis for taxing federal interest. The quoted language might be sufficient to qualify a tax under a dictionary definition of "franchise tax", but it is not sufficient to qualify a tax under the reasoning of the Supreme Court permitting franchise taxes to be excepted from the Rev. Stat. § 3701 prohibition against state and local taxation, because of the total absence of municipal authority over "the privilege of doing business in the City."[7]

(2) Current Law

Perhaps more significant for present purposes is the fact that the opinion of the court below also conflicts with the Supreme Court's more recent interpretation of Rev. Stat. § 3701 as amended in 1959. In *American Bank & Trust Co.* v. *Dallas Co.*, 463 U.S. 855, reh'g den., 463 U.S. 1250 (1983), the Court extensively reviewed and analyzed the 1959 amendment.

First the Court noted that:

> "The 1959 amendment rejected and set aside this Court's rather formalistic pre-1959 approach to § 3701." 463 U.S. at 862.
>
> * * *
>
> "The language of § 3701 encompasses 'every form of taxation,' and is inconsistent with implied exceptions." 463 U.S. at 864.

These statements make clear that the 1959 version certainly should not be construed to broaden the definition or scope of the franchise tax exception as it previously had been formulated (as discussed above).

The Court then reviewed the legislative history of the 1959 amendment, pointing out that it was largely in response to a position taken by the State of Idaho that so long as a state tax-

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7 See discussion, *supra*, p. 10.

ing statute did not impose a tax "on" federal obligations, it was permissible. The Court noted:

> "To answer this argument, the amendment abolished the formalistic inquiry whether the tax is *on* a distinct interest, and replaced it with the inquiry whether 'computation of the tax' requires consideration of federal obligations." 463 U.S. at 867. (Emphasis in original.)

In addition, the Court gave lengthy consideration to the taxing authority's contention that since the federal statute governing the taxation of national banks (Rev. Stat. § 5219, as amended, 12 U.S.C. § 548) permitted the tax in question, § 3701 should also be construed to permit it. The Court rejected this contention, pointing out that "§ 5219 and § 3701 have always been directed to, and have protected, these separate federal interests [national banks and federal obligations]." 463 U.S. at 870.

The New York Court of Appeals opinion in the present case disregarded all of the *American Bank & Trust* precepts summarized in the preceding two paragraphs. As previously discussed, the Court of Appeals accorded great significance to the formalistic 15-word privilege clause in the City bank tax ordinance. In addition, in seeking to distinguish state court cases cited by petitioners in which the City unincorporated business tax[8] had consistently been held to be an income tax, the Court of Appeals based its distinction on the fact that the unincorporated business tax is "expressly imposed *on* the taxable income of every unincorporated business." (5a, n.5) (Emphasis in original).

And, finally, the Court of Appeals ignored the distinction between Rev. Stat. § 3701 and Rev. Stat. § 5219 which was emphasized in the *American Bank & Trust* case. The Court of Appeals countered petitioners' contention that a city tax cannot be a franchise tax by stating: "The further answer to petitioners' argument in this regard is the fact that a state may

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8 The unincorporated business tax is also a privilege tax authorized by the very same state enabling act which authorized the bank tax. See N.Y. General City Law, Model Local Law § 101, App., p. 583 (McKinney's).

collect a franchise tax on national banking associations or banks incorporated under the laws of other jurisdictions . . . even though it does not possess the power to grant such corporations the license 'to exist' in the state." (4a) State taxation of national banks is, of course, based on the authority of Rev. Stat. § 5219, as amended, which, unlike Rev. Stat. § 3701, does not limit states to franchise taxation.[9] Also, the state (as distinguished from the City) does have licensing authority over banks incorporated in other jurisdictions (N.Y. Bank. L., § 200).

C. Summary

This Court should not allow the Court of Appeals decision to stand, because if it does it will be:

1. Resurrecting the formalistic approach rejected by the 1959 amendment of Rev. Stat. § 3701 and the Supreme Court cases interpreting that amendment.

2. Permitting United States obligations to be doubly burdened by a 12% New York State franchise tax and a 13.823% New York City business privilege tax.[10]

3. Anomalously expanding the post-1959 exceptions to Rev. Stat. § 3701 substantially beyond any exception previously held to exist—all in the face of a contrary Congressional intention to narrow the exceptions.

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9 As in effect in 1976, Rev. Stat. § 5219 provided simply that for tax purposes, "a national bank shall be treated as a bank organized and existing under the laws of the State or other jurisdiction within which its principal office is located." 12 U.S.C. § 548.

10 Both courts below relied on a Tennessee case to justify the double taxation. *First American Bank of Knoxville* v. *Olsen*, 751 S.W.2d 417 (Tenn. 1987), app. dism., 485 U.S. 1001 (1988). However, that case concerned two state taxes which, in the words of the Tennessee Supreme Court, were "consistently construed together as one coordinate scheme of taxation." 751 S.W.2d at 421. Moreover, there is a single "Franchise and Excise Tax Return" for both taxes and the current rates are .25% of capital or tangible assets and 6% of income, respectively. See CCH Tenn. Tax Rep. ¶ 12-518.

The question of first impression in this case of whether an income based city tax can be imposed on interest income received on United States obligations is of vital importance not only to petitioners but also to the many banks and financial institutions doing business in New York City (and, of course, to the United States Treasury for the benefit of which the statutory immunity was enacted), because it is a common practice of banks and many financial institutions to hold substantial amounts of federal obligations.[11]

RULE 29.4(c) STATEMENT

In view of the possibility that 28 U.S.C. § 2403(b) may be applicable, this Petition is being served upon the Attorney General of the State of New York.

CONCLUSION

This Court should grant this Petition for Writ of Certiorari and review the decision of the New York Court of Appeals.

Respectfully submitted,

DAVID SACHS
Counsel of Record for Petitioners
WHITE & CASE
1155 Avenue of the Americas
New York, New York 10036
(212) 819-8357

July 30, 1992

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11 For example, the Federal Reserve Bulletin for June, 1992 (Vol. 78, No. 6 at A19) reports that at March, 1992, commercial banks held $557.3 billion in United States securities, representing 16% of their total assets aggregating $3.5 trillion.

APPENDIX

Opinion and Remittitur of the Court of Appeals, State of New York, Entered May 12, 1992.

STATE OF NEW YORK
COURT OF APPEALS
No. 63

In the Matter of Bankers Trust New York Corporation et al.,

Appellants,

—v.—

Department of Finance of The City of New York et al.,

Respondents.

David Sachs, for appellants.
Amy F. Nogid, for respondents.

OPINION

This opinion is uncorrected and subject to revision before publication in the New York Reports.

YESAWICH, J.:

The New York City Financial Corporation Tax is imposed on financial corporations for the privilege of doing business in the City in a corporate or organized capacity. The issue presented

is whether this tax is a franchise tax or a nonproperty tax in lieu thereof, thus allowing the City to take into account when calculating the tax, income petitioners received from Federal securities without violating the Federal Public Debt Statute (former 31 USC § 742, as amended 31 USC § 3142[a]). We agree with the Appellate Division that the City Financial Corporation Tax functions as a franchise tax, making its application to the interest income earned by petitioners on Federal obligations held by them proper.

(I)

In 1976, petitioners Bankers Trust New York Corporation, a bank holding company, and its principal New York subsidiary, Bankers Trust Company, which are organized under the laws of New York State and maintain their principal offices in New York City, earned interest in an aggregate amount of $47,701,000 on certain debt obligations of the Federal Government and its agencies that they held in inventory and for investment purposes. This amount was included in full in their consolidated 1976 New York City Financial Corporation Tax return; all expenses incurred by petitioners to produce such interest income were deducted. The tax was ultimately paid in 1983 and in June 1984 petitioners filed a claim for a refund of $3,997,479 plus interest, the portion of the City Financial Corporation Tax imposed on interest earned on these government obligations. They claimed that subjecting this income to the Financial Corporation Tax is precluded by the Federal Public Debt Statute (Rev. Stat § 3701, 31 USC § 742[1959])[1], which exempted United States government obligations and interest thereon from state or municipal taxation "except nondiscriminatory franchise or other nonproperty taxes in lieu thereof, imposed on corporations."

In August 1984, respondent Department of Finance issued a notice of disallowance, stating that the City Financial

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1 In 1982, Rev. Stat § 3701, 31 USC § 742, was reformulated without substantive change as 31 USC § 3124 (a) (*American Bank & Trust Co. v Dallas County*, 463 US 855, 859 n 1, *rehearing denied* 463 US 1250).

Corporation Tax (which is measured by a corporation's entire net income) prohibited deductions or exclusions "for any part of any income from * * * interest on any kind of stock, securities or indebtedness" (Administrative Code of City of New York former § R46-37.3[b][1] [recodified at § 11-641(b)(1)(B)]). After a hearing, respondent Commissioner of Finance sustained the notice of disallowance and denied petitioners' refund claim, concluding that the City Financial Corporation Tax was a franchise tax, or at the very least a non-property tax in lieu of a franchise tax, within the meaning of the Federal Public Debt Statute.

This article 78 proceeding, timely commenced by petitioners, challenges the Commissioner's determination. Upon transfer of the proceeding by Supreme Court, the Appellate Division unanimously confirmed the determination and dismissed the petition, holding that, although the City Financial Corporation Tax does not employ the words "franchise tax" and is measured by income, it nonetheless functions as a franchise tax, not an income tax, and therefore is immune from the provisions of the Federal Public Debt Statute. This appeal ensued.

(II)

Petitioners' principal arguments are that (1) the City of New York has no authority to impose a corporate franchise tax, only the State can do so and it already does (Tax Law § 1451; 20 NYCRR § 16-1.1) and (2) even were the City so empowered, its Financial Corporation Tax is not in fact a franchise tax. For the reasons that follow, we conclude that petitioners' arguments are unpersuasive.

(1)

There are two types of franchise taxes, "organization taxes" (taxes established for the privilege of existing as a corporation) and "doing business" taxes (taxes imposed on the corporation's privilege of doing business within the boundaries of the taxing authority) (*see Werner Mach. Corp. v Director Div. of Taxation*, 17 NJ 121, 125-126, 110 A2d 89, 91, *affd* 350 US 534). That the State Legislature circumscribed the authority it has granted

to the City to that of merely setting "doing business" taxes (Administrative Code of City of New York former § R46-37.1), while retaining solely unto itself the prerogative to impose "organization taxes", is a seductive but hardly compelling reason to conclude, as petitioners suggest, that the tax at issue is not a franchise tax.

The State is empowered to grant franchises allowing corporations to exist as well as do business here (*see People ex rel. Bass, Ratcliff & Gretton v State Tax Commn.*, 232 NY 42). Pursuant to the New York Laws of 1966[2] and the accompanying Model Local Law § 12(1)[3], the State Legislature authorized New York City as its agent to levy a franchise tax on corporations for the privilege of doing business in the City, with the revenue collected remaining in the City's control (*see*, NY Const. Art 9 § 2[c] [8]; *see, e.g., Sonmax, Inc. v City of New York*, 43 NY2d 253, 257; *Kesbec, Inc. v McGoldrick*, 278 NY 293, 295; *New York Steam Corp. v City of New York*, 268 NY 137, 145; *City of Schenectady v State of New York*, 80 Misc 2d 223, 225; *cf., Albany Area Builders Assn. v Guilderland*, 74 NY2d 372, 379). Collection of this tax by the City does not make it any less a state authorized franchise tax. The further answer to petitioners' argument in this regard is the fact that a state may collect a franchise tax on national banking associations or banks incorporated under the laws of other jurisdictions (*see, Tradesmans Nat. Bank v Oklahoma Tax Commn.*, 309 US 560, 563-565; *see also, State Dept. of Assessments & Taxation v Maryland Nat. Bank*, 310 Md 664, 665, 531 A2d 294, 295, *appeal dismissed* 486 US 1048), even though it does not possess the power to grant such corporations the license "to exist" in the state.

Moreover, the presence of the co-existing State franchise tax[4] does not require the conclusion that the City's Financial

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2 The New York Laws of 1966, ch 772, § 1, at 1586, authorize "any city having a population of one million or more * * * to adopt and amend local laws imposing * * * taxes on * * * financial corporations * * *".

3 The enabling legislation's Model Local Law § 12 provides that a "[t]ax based on net income" be imposed '[f]or the privilege of doing business in the city * * *" (*id.*, at 1612).

4 State Tax Law § 1451(a) imposes a tax on every banking corporation "for the privilege of exercising its franchise or doing business in this state in a corporate or organized capacity." The amount of the tax owed is measured by

Corporation Tax is not a franchise tax. A number of acceptable forms of taxation can be imposed within the nondiscriminatory franchise tax exemption; the Federal Public Debt Statute does not limit the state to condition the exercise of corporate powers upon the payment of only one tax (*see*, *First American Nat. Bank v Olsen*, 751 SW2d 417, 421 [Tenn], *appeal dismissed* 485 US 1001).

(2)

Whether the City Financial Corporation Tax is a bona fide franchise tax, is a matter to be "determined by its operation rather than by particular descriptive language which may have been applied to it" (*Educational Films Corp. v Ward*, 282 US 379, 387). That the tax does not contain the word "franchise" in its title or text is not determinative (*see*, *e.g.*, *Reuben L. Anderson-Cherne, Inc. v Commissioner of Taxation*, 303 Minn 124, 126-127, 226 NW2d 611, 614, *appeal dismissed* 423 US 886; *Pacific First Fed. Savings Bank v Department of Rev.*, 308 Ore 332, 334, 779 P2d 1033). And, the Supreme Court has repeatedly recognized that simply because a tax on a franchise is measured by income[5], as is the tax at hand, does not connote that it cannot qualify as a franchise tax within the meaning of the statute (*see*, *e.g.*, *Werner Machine Co. v Director of Taxation*, 350 US 492, 493-494; *Pacific Co. v Johnson*, 285 US 480, 489; *Educational Films Corp. v Ward*, *supra*, at 387-391; *Flint v Stone Tracy Co.*, 220 US 107, 162; *Home Ins. Co. v New York*, 134 US 594, 600, *affg* 92 NY 328).

A true distinction between an income or property tax and a bona fide franchise tax[6] imposed upon a corporation for the privilege of

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the "taxpayer's entire net income" with certain adjustments not relevant here (Tax Law § 1455).

5 Insofar as petitioners advert to the fact that the New York City unincorporated business tax has consistently been held to be an income tax (*see Matter of Byrn v Chu*, 105 AD2d 963, *lv denied* 64 NY2d 606), we note that tax is "expressly imposed *on* the 'taxable income of every unincorporated business * * * ' " (*Matter of Berardino v New York State Tax Commn.*, 78 AD2d 936, 937 quoting Administrative Code of City of New York, S46-3.0) (emphasis added).

6 The Department of Finance correctly observes that we previously affirmed on the opinion of Supreme Court a decision stating that the New York

doing business in the state is that a franchise tax—unlike an income or property tax—requires the earning of income, or the possession of property, to coincide with the prerogative of doing business in the corporate form (*see, Educational Films Corp. v Ward, supra*, at 388; *Reuben L. Anderson-Cherne, Inc. v Commissioner of Taxation, supra*, at 614-615; *Savings League v Wisconsin Dept. of Revenue*, 141 Wis2d 918, 924-925; 416 NW2d 650, *review denied* 144 Wis2d 956, 428 NW2d 554, *appeal dismissed* 488 US 806). If the taxpayer could still be liable for the tax despite corporate dissolution or the complete cessation of business, it is a tax on property or income, not on the franchise of doing business.

That the New York City Financial Corporation Tax is indeed a franchise tax is borne out by the fact that, tracking the language of the enabling statute's Model Local Law § 12[1] (*supra*), it is levied "[f]or the privilege of doing business in the city in a corporate or organized capacity * * *" and if petitioners were to dissolve or cease doing business in the City they would no longer be subject to the tax (Administrative Code of City of New York former § R46-37.1 [a] [recodified at § 11-639]).

The New York City Financial Corporation Tax being a franchise tax within the meaning of the Federal Public Debt Statute, inclusion of interest on Federal Government obligations to determine the amount owed by petitioners for the tax year 1976 under such tax was expedient. Accordingly, the judgment of the Appellate Division should be affirmed, with costs.

* * * *

Judgment affirmed, with costs. Opinion by Judge Yesawich. Chief Judge Wachtler and Judges Kaye, Titone, Hancock and Bellacosa concur. Judge Simons took no part.

Decided May 12, 1992

City Financial Corporation Tax was a franchise tax (*see, Woodside Savings & Loan Assn. v Gallman*, 73 Misc 2d 357, 360, *affd on opn of Special Term* 34 NY2d 674, *appeal dismissed* 419 US 810). However, that case did not involve whether the financial corporation tax was a franchise tax within the meaning of the Federal Public Debt Statute.

COURT OF APPEALS
STATE OF NEW YORK
No. 63

In the Matter of Bankers Trust
New York Corporation et al.,

Appellants,

—v.—

Department of Finance of The City of New York et al.,

Respondents.

Remittitur

THE HON. SOL WACHTLER,
Chief Judge, Presiding

The appellants in the above entitled appeal appeared by White & Case, Esqs.; the respondents appeared by Hon. O. Peter Sherwood, Corporation Counsel of the City of New York.

The Court, after due deliberation, orders and adjudges that the judgment is affirmed, with costs. Opinion by Judge Yesawich. Chief Judge Wachtler and Judges Kaye, Titone, Hancock and Bellacosa concur. Judge Simons took no part.

The Court further orders that this record of the proceedings in this Court be remitted to the Supreme Court, New York County, there to be proceeded upon according to law.

I certify that the preceding contains a correct record of the proceedings in this appeal in the Court of Appeals and that the papers required to be filed are attached.

/s/ DONALD M. SHERAW
Donald M. Sheraw, Clerk of the Court

Court of Appeals, Clerk's Office, Albany, May 12, 1992.

**Order of the Court of Appeals,
State of New York, Granting Leave to Appeal,
Entered October 17, 1991.**

STATE OF NEW YORK
COURT OF APPEALS
Mo. No. 907

In the Matter of Bankers Trust
New York Corporation &c.,

Appellants,

—v.—

Department of Finance of The City of New York et al.,

Respondents.

At a session of the Court, held at Court of Appeals Hall in the City of Albany on the seventeenth day of October A.D. 1991

Present, HON. SOL WACHTLER,
Chief Judge, presiding.

A motion for leave to appeal to the Court of Appeals in the above cause having been heretofore made upon the part of the appellants herein and papers having been duly submitted thereon and due deliberation thereupon had, it is

ORDERED, that the said motion be and the same hereby is granted.

/s/ DONALD M. SHERAW
Donald M. Sheraw
Clerk of the Court

**Order of the Court of Appeals,
State of New York, Dismissing Appeal,
Entered July 2, 1991.**

STATE OF NEW YORK
COURT OF APPEALS
Mo. No. 730 SSD 47

In the Matter of Bankers Trust
New York Corporation &c.,

Appellants,

—v.—

Department of Finance of The City of New York et al.,

Respondents.

At a session of the Court, held at Court of Appeals
Hall in the City of Albany on the second day of
July A.D. 1991

Present, HON. SOL WACHTLER,
Chief Judge, presiding.

The appellants having filed notice of appeal in the above title and due consideration having been thereupon had, it is

ORDERED, that the appeal be and the same hereby is dismissed without costs, by the Court *sua sponte*, upon the ground that no substantial constitutional question is directly involved.

/s/ DONALD M. SHERAW
Donald M. Sheraw
Clerk of the Court

Decision and Order of the Supreme Court of the State of New York, Appellate Division, First Department, Entered March 21, 1991.

In re Application of Bankers Trust New York Corporation, et al.,

Petitioners,

—against—

Department of Finance of The City of New York, et al.,

Respondents,

For a Judgment etc.

Carro, J.P., Ellerin, Wallach, Kupferman, Kassal, JJ.

Determination of the Department of Finance of the City of New York dated June 12, 1990, which, after a hearing, denied the petitioners' claim for a refund of New York City Financial Corporation Tax in the amount of $3,997,479 plus interest for the tax year ending December 31, 1976 (transferred to this Court by order of Supreme Court, New York County [Jacqueline W. Silbermann, J.] entered on or about October 24, 1990), unanimously confirmed and the petition dismissed, without costs.

New York Laws of 1966, Ch. 772, Section 1, (McKinney's 1966 Session Laws of New York, Laws of 1966, Ch. 772 p. 941)[1], authorizes "any city having a population of one million or more * * * to adopt and amend local laws imposing * * * taxes on * * * financial corporations * * *". The Model

1 Entitled, "City Corporate Business and City Unincorporated Business Income Tax".

Local Law, immediately following the enabling statute at § 12 (*Id.* at p. 974), expressly states that a "[t]ax based on net income" be imposed "for the privilege of doing business in the City". The New York City Corporation Tax (Admin. Code § 11-639 (a) *et seq.* [formerly § R46-37.0 *et seq.*] tracks the language of the enabling legislation's model law. While it does not employ the words "franchise tax", it functions as such a tax nonetheless, and equivalent language is found in the section, namely, "for the privilege of doing business in the City in a corporate or organized capacity * * *". (*See Woodside Sav. & Loan v. Gallman*, 73 Misc.2d 357 [Sup Ct, NY County, 1972] *affd on op of Korn, J. at Special Term* [34 NY2d 674].) Even though measured by income, the New York City Corporation tax is not to be viewed as a tax on income. (*See First Nat. Bank of Knoxville v. Olsen*, ____ Tenn ____, 751 SW2d 417, 422 [Tenn. 1987]. For that reason, it is exempt from the provisions of Rev. Stat. § 3701, 31 USC 742 as amended, [formerly 31 USC § 3124(a)].)

Rev. Stat. § 3701, 31 USC 742 does not limit the States' taxing authority so that only one such tax can be imposed; a number of acceptable forms of taxation can be imposed concurrently within the exception of the federal immunity statute. (*See First Nat. Bank of Knoxville v. Olsen, supra.*)

THIS CONSTITUTES THE DECISION AND ORDER OF THE SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT

ENTERED: March 21, 1991

/s/ FRANCIS X. GALDI
Clerk

Order of Transfer of the Supreme Court of the State of New York, New York County, Dated October 16, 1990.

SUPREME COURT OF THE
STATE OF NEW YORK—NEW YORK COUNTY
Index Number 19825/90
PART 50L

In the Matter of the Application of
BANKERS TRUST NEW YORK CORPORATION,

Petitioners,

—against—

DEPARTMENT OF FINANCE OF THE CITY OF NEW YORK, et ano,

Respondents.

PRESENT: HON. JACQUELINE W. SILBERMANN
Justice.

The following papers numbered 1 to ____ read on this motion to _____

Notice of Motion—Affidavits—Exhibits 1, 2

Answering Affidavits—Exhibits 3

Replying Affidavits _____

Upon the foregoing papers it is ordered that this motion is transferred to the Appellate Division First Department pursuant

to CPLR 7803(4) as there exists an issue of substantial evidence.

This constitutes the decision and order of the court.

Dated October 16, 1990

/s/ JACQUELINE W. SILBERMANN
J.S.C.

Final Determination and Decision of the Department of Finance of the City of New York, Dated June 12, 1990 and June 6, 1990, Respectively.

[Seal of The City of New York]

In Reply Refer to:
Tel. (718) 403-3700

The City of New York
Department of Finance
Carol O'Cleireacain, Commissioner
Bureau of Hearings
The Municipal Building
One Centre Street
New York, N.Y. 10007
Arthur S. Katz, Director

Bankers Trust New York
Corporation
280 Park Avenue
New York, NY 10017

SERVICE IN AN ARTICLE 78 PROCEEDING OR IN AN APPEAL TO THE TAX APPEALS TRIBUNAL MUST BE MADE ON THE COMMISSIONER OF FINANCE

Date: June 12 1990
In Re:
Name: Bankers Trust New York Corporation
Address: 280 Park Avenue New York, NY 10017
Amount of Claim: $3,997,479.00
Tax: Financial Corporation Tax

Period: Tax Year 1976
Claim No.: _____
Reg. No.: ____
Empl. Ident. No.: 13-6180473

FINAL DETERMINATION

Please be advised that your claim for refund is hereby denied for the reasons checked below:

[X] Based upon findings as a result of a hearing held in this office.

[ ] You withdrew your claim for refund by letter dated ____, 199_.

[ ] You withdrew your claim for refund on the record of hearing held on ____ 199_.

This determination is final and irrevocable.

Very truly yours,

/s/ CAROL O'CLEIREACAIN
Carol O'Cleireacain
Commissioner of Finance

BH–44/89

cc: David Sachs, Esq.
White & Case
1155 Ave. of the Americas
New York, NY 10036

SN:ds

[Seal of The City of New York]
THE CITY OF NEW YORK
DEPARTMENT OF FINANCE

DEPARTMENT OF FINANCE
BUREAU OF HEARINGS
The Municipal Building
One Centre Street
New York, N.Y. 10007

FHD(274)FC-6/90(0-0-0)
FINANCIAL CORPORATION TAX
JUNE 6, 1990

In the Matter of the Petition

of

BANKERS TRUST NEW YORK CORPORATION

for Redetermination of a Notice of Disallowance Denying a Claim for Refund of Financial Corporation Tax under former Title R (Part III) of Chapter 46 of the Administrative Code of the City of New York for tax year 1976.

DECISION

Petitioner, Bankers Trust New York Corporation, 280 Park Avenue, New York, New York 10017, filed a petition for redetermination of a Notice of Disallowance denying a claim for refund of the financial corporation tax under former Title R (Part III) of Chapter 46 (now Chapter 6 (Subchapter 3) of Title 11) of the Administrative Code of the City of New York for the tax year 1976.

A hearing was held before Stanley C. Nosol, Hearing Officer, at the offices of the Department of Finance on April 11, 1988 and July 20, 1988. Post-hearing memoranda of law were submitted by the petitioner and the Department of Finance on October 11, 1988 and November 8, 1988, respectively. A reply memorandum of law was submitted by the petitioner on December 9, 1988. Petitioner appeared by White & Case, Esqs. (David Sachs, Esq., of counsel). The Department of Finance was represented by Peter Rabinowitz, Esq. of the Corporation Counsel's office.

ISSUES

I. Whether the New York City financial corporation tax impermissibly taxed interest earned on obligations of the United States government in violation of Rev. Stat. § 3701, 31 U.S.C.A. § 742 (1959)* which expressly provided that United States government obligations shall be exempt from state, municipal and local taxes except for nondiscriminatory franchise taxes or nonproperty taxes in lieu thereof.

II. Whether, if income from federal obligations may not be taxed under the New York City financial corporation tax, expenses incurred to produce such income should be disallowed as a deductible expense.

FACTS

1. For tax year 1976, petitioner, Bankers Trust New York Corporation ("BTNY"), a bank holding corporation, and a number of its subsidiaries, including Bankers Trust Company ("BT Co.") filed a Combined New York City Financial Corporation Tax Return. Both BTNY and BT Co. were organized under the laws of New York State and maintained their principal office in New York City.

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* In 1982, Rev. Stat. § 3701, 31 U.S.C.A. § 742, was reformulated without substantive change as 31 U.S.C.A. § 3124(a).

2. During 1976, BT Co. held direct obligations of the United States government ("government obligations") as well as obligations of United States government agencies ("agency obligations"). BT Co. was a dealer in both such obligations and held such obligations in inventory ("trading account"). In addition, BT Co. also held such obligations for investment purposes ("investment account").

3. BT Co. earned interest on the government obligations and agency obligations which were held in the investment and trading accounts. In tax year 1976, the average monthly balances of government obligations and agency obligations held by BT Co. in each account (rounded to the nearest thousand) were as follows:

	INVESTMENT ACCOUNT	TRADING ACCOUNT	TOTALS
Government Obligations	$328,861,000	$321,042,000	$649,903,000
Agency Obligations	90,345,000	36,566,000*	126,911,000
Total Average Monthly Balances	$419,206,000	$357,608,000	$776,814,000

4. In tax year 1976, the amounts of interest income earned on such obligations (rounded to the nearest thousand) were as follows:

	INVESTMENT ACCOUNT	TRADING ACCOUNT	TOTALS
Government Obligations	$21,013,000	$17,773,000	$38,786,000
Agency Obligations	6,105,000	2,458,000**	8,563,000
Total Interest Income	$27,118,000	$20,231,000	$47,349,000

* Included $4,580,000 in average monthly balances of obligations of the Government National Mortgage Association ("GNMA").

** Included $342,000 in interest income on GNMA obligations.

5. BTNY also held government obligations and agency obligations as investments. In tax year 1976 it earned $348,000 from such government obligations and $4,000 from such agency obligations.

6. In tax year 1976 the aggregate amounts of interest income (rounded to the nearest thousand) earned by BTNY and BT Co. on government obligations and agency obligations (including obligations of GNMA) were as follows:

	GOVERNMENT OBLIGATIONS	AGENCY OBLIGATIONS	TOTALS
BTNY	$ 348,000	$ 4,000	$ 352,000
BT Co.	38,786,000	8,563,000	47,349,000
Totals	$39,134,000	$8,567,000	$47,701,000

7. In tax year 1976 the aggregate average total assets held by BTNY and BT Co. and the total interest expense incurred by each (rounded to the nearest thousand) were as follows:

	BTNY	BT Co.
Average Total Assets	$1,424,053,000	$20,300,152,000
Total Interest Expense	37,170,000	759,845,000

8. Petitioner, on its Combined New York City Financial Corporation Tax Return for tax year 1976 included in gross income, the total interest income (rounded to the nearest thousand) of $47,701,000 earned from government obligations and agency obligations. Petitioner also deducted all expenses which were incurred to produce such income.

9. By letter dated June 12, 1984, petitioner filed a claim for refund of financial corporation tax for tax year 1976. Petitioner claimed that there should be excluded from its combined income subject to the New York City financial corporation tax the said amount of $47,701,000 in interest income earned from government obligations and agency obligations. The exclusion

of this amount would result in petitioner having a negative amount of taxable income for tax year 1976 (in the amount of $21,713,948), after taking into account changes resulting from federal and New York City audits and the filing of an amended return on May 31, 1983. However, pursuant to the limitations contained in former section R46-68.0.1 (now section 11-678.1) of the Administrative Code of the City of New York, the petitioner limited its request for refund to $3,997,479, plus interest. This is the amount of tax paid by petitioner for the 1976 tax year within two years of the date on which the claim for refund was filed (i.e., June 12, 1984)*. The total tax which petitioner had paid for 1976 was $8,636,630.

10. On August 9, 1984, the Department of Finance issued a Notice of Disallowance, which denied in full petitioner's claim for refund for the tax year 1976 in the amount of $3,997,479. The reason stated for the disallowance was as follows:

> Pursuant to Section R46-37.3(b)(1) [now section 11-64.1(b)(1)] of the New York City Administrative Code which states that there shall be no deductions or exclusion 'for any part of any income from dividends or interest on any kind of stock, securities or indebtedness.'

11. Petitioner contended that the New York City financial corporation tax impermissibly taxed interest earned on obligations of the United States government in violation of Rev. Stat. § 3701, 31 U.S.C.A. § 742 (1959) which expressly provided that United States government obligations shall be exempt from state, municipal, and local taxes except for nondiscriminatory franchise taxes or nonproperty taxes in lieu thereof.

12. In addition, petitioner contended that, if interest earned on federal obligations is exempt from the New York City financial corporation tax, the expenses incurred to produce this non-

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* $3,975,495 was paid on June 15, 1982 pursuant to a City audit and $21,984 was paid on February 23, 1983 pursuant to City changes resulting from a federal audit.

taxable income may not be disallowed in the absence of a statutory requirement for such disallowance.

13. The Department of Finance contended that the New York City financial corporation tax is a nondiscriminatory franchise tax or a nonproperty tax in lieu of a franchise tax and, therefore, under Rev. Stat. § 3701, 31 U.S.C.A. § 742 (1959) income from federal obligations is not exempt from such tax. In the alternative, the Department of Finance contended that if the taxation of income from federal obligation under the City's financial corporation tax is not permissible under Rev. Stat. § 3701, 31 U.S.C.A. § 742 (1959) then, the expenses incurred to produce such non-taxable income should be disallowed.

CONCLUSIONS OF LAW

A. That Rev. Stat. § 3701, 31 U.S.C.A. § 742 (1959)*, as in effect in 1976, the year in issue, provided:

> Except as otherwise provided by law all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, *except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations* and except estate taxes or inheritance taxes (emphasis added).

B. That the State enabling legislation which authorized the imposition of the New York City financial corporation tax provides, in pertinent part, as follows:

> AN ACT to enable any city having a population of one million or more to raise tax revenue by authorizing the imposition of taxes on general, financial, insurance and transportation corporations and on unincorporated busi-

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* In 1982, Rev. Stat. § 3701, 31 U.S.C.A. § 742, was reformulated without substantive change as 31 U.S.C.A. § 3124(a).

nesses to provide for the administration and review of such new taxes, to provide for the suspension of any tax on gross income of conduit companies imposed by such city and for the suspension and repeal of any general business and financial tax imposed by any such city, to amend the tax law in relation to authorizing an increase in the rates of tax which such city may impose on utilities and vendors of utility services, and to repeal article two-B of the general city law, authorizing the imposition of a general business and financial tax by such city

. . .

Section 1. Notwithstanding any other provision of law to the contrary, any city having a population of one million or more, acting through its local legislative body, is hereby authorized and empowered to adopt and amend local laws imposing for any such city taxes on general corporations, financial corporations, insurance corporations and transportation corporations. The terms of such local law or local laws shall be, substantially, as follows except that the appendix in such local laws may be amended for the purpose of conforming it with the United States internal revenue code or other federal laws relating to taxation as presently in effect or as they may be amended:

. . .

L. 1966, c.772.

C. That former section R46-37.1(a) (now section 11-639.(a)) of the Administrative Code of the City of New York (the "Code") provides, in pertinent part, as follows:

> For the privilege of doing business in the city in a corporate or organized capacity, a tax . . . is hereby annually imposed on every banking corporation for each of its taxable years, or any part thereof. . . .

D. That former section R46-37.3 (now section 11-641) of the Code provides, in pertinent part, as follows:

> (a) Entire net income means total net income from all sources which shall be the same as the entire taxable income which the taxpayer is required to report to the United States treasury department, except as hereinafter provided.
>
> (b) Entire net income shall be computed without the deduction or exclusion of:
>
> > (1) any part of any income from dividends or interest on any kind of stock, securities or indebtedness. . . .

E. That the New York City financial corporation tax specifically states that it is "[f]or the privilege of doing business in the city in a corporate or organized capacity. . . ." Code section R46-37.1.

F. That the term "franchise" has been consistently equated with the term "privilege". See, e.g., Black's Law Dictionary 593 (5th ed. 1979) (franchise tax is tax on right and privilege of carrying on business in character of a corporation); 71 Am. Jur. 2d. *State and Local Taxation* § 266 (1973); 60 N.Y. Jur. 2d *Franchises* § 1 (1987).

G. That, in a leading treatise, it is stated that "[m]ost often . . . a 'franchise tax' is a tax imposed upon a corporation for the right or privilege of being a corporation or of doing business in a corporate capacity." 14A Fletcher Cyclopedia of the Law of Private Corporations § 6953 (1980).

H. That the New York City financial corporation tax is a franchise tax because it is imposed on banking corporations for the privilege of doing business in the City in a corporate capacity. The exception for franchise taxes in Rev. Stat. § 3701, 31 U.S.C.A. § 742 (1959) is not limited to taxing the granting of

a franchise but also includes the franchise to carry on a business in a corporate capacity.

I. That the New York City financial corporation tax is imposed pursuant to State enabling legislation (L. 1966, c.772) and is, therefore, as are all the City's taxes, an extension of the State's taxing authority. That it was the State, and not the City, which granted petitioner's initial corporate franchise is not, therefore, relevant.

J. That notice is taken of the parallel nature and operation of the State and City tax statutes. That as the State tax not only meets all the requisites of a franchise tax but is specifically called a franchise tax, it must follow that the City tax, notwithstanding the absence of the word "franchise" in the City tax law, is also a franchise tax, within the meaning of Rev. Stat. § 3701, 31 U.S.C.A. § 742 (1959).

K. That, at the very least, the State intended and did authorize the City to levy a nonproperty tax in lieu of a franchise tax. Certainly the State could have imposed a higher State franchise tax on those banking corporations doing business in cities of more than one million persons and then apportioned such extra tax revenues to such cities. Thus, the City financial corporation tax, in its nature and operation, is "in substitution" of a higher State franchise tax in cities of more than one million persons. The State by delegating this right to impose such a tax to the local legislature has avoided the need to apportion tax revenues and at the same time has provided for the special revenue needs of its largest cities.

L. That the taxation of interest income from federal obligations under the City's financial corporation tax is permissible under Rev. Stat. § 3701, 31 U.S.C.A. § 742 (1959).

M. That in view of Conclusion of Law "L", above, it is unnecessary to determine whether expenses incurred to produce this income should be disallowed as a deductible expense.

N. That the Department of Finance properly denied petitioner's claim for refund of the financial corporation tax.

O. That the petition of Bankers Trust New York Corporation is denied and the Notice of Disallowance, issued August 9, 1984 is sustained.

DATED: NEW YORK, NEW YORK
JUNE 6, 1990

/s/ CAROL O'CLEIREACAIN
Carol O'Cleireacain
Commissioner of Finance

/dh

United States Supreme Court
Cases Permitting or Precluding
State or Local Taxation of Federal Obligations or Interest Thereon
1829-1959

Name of Case	Citation	Taxing Jurisdiction	Type of Tax	Court's Determination
1. Werner Machine Co. v. Director of Division of Taxation	350 U.S. 492 (1956)	State of New Jersey	Franchise tax on net worth	Tax permissible
2. Society for Savings v. Bowers	349 U.S. 143 (1955)	State of Ohio	Property tax on bank capital	Tax impermissible
3. New Jersey Realty Title Ins. Co. v. Division of Tax Appeals	338 U.S. 665 (1950)	State of New Jersey*	Property tax	Tax impermissible
4. Tradesmens National Bank v. Oklahoma Tax Commission	309 U.S. 560 (1940)	State of Oklahoma	Franchise tax on net income	Tax permissible

Name of Case	Citation	Taxing Jurisdiction	Type of Tax	Court's Determination
5. Schuylkill Trust Co. v. Pennsylvania	296 U.S. 113 (1935)	State of Pennsylvania	Discriminatory tax on shares	Tax impermissible
6. Pacific Co. v. Johnson	285 U.S. 480 (1932)	State of California	Franchise tax on net income	Tax permissible (dictum)
7. Educational Films Corp. v. Ward	282 U.S. 379 (1931)	State of New York	Franchise tax on net income	Tax permissible (dictum)
8. Missouri *ex rel.* Missouri Ins. Co. v. Gehner	281 U.S. 313 (1930)	State of Missouri*	Property tax on insurance co. assets	Tax impermissible
9. MacAllen Co. v. Massachusetts	279 U.S. 620 (1929)	State of Massachusetts	Excise tax on privilege of doing business	Tax impermissible (intentional tax on U.S. obligations)
10. Northwestern Mutual Life Ins. Co. v. Wisconsin	275 U.S. 136 (1927)	State of Wisconsin	Life insurance company license tax on gross income	Tax impermissible

Name of Case	Citation	Taxing Jurisdiction	Type of Tax	Court's Determination
11. Miller v. Milwaukee	272 U.S. 713 (1927)	State of Wisconsin*	Tax on dividend income derived from U.S. obligations	Tax impermissible (intentional tax on U.S. obligations)
12. Des Moines Nat'l Bank v. Fairweather	263 U.S. 103 (1923)	State of Iowa*	Bank shares tax on shareholders, but payable by banks	Tax permissible
13. Farmers & Mechanics Sav. Bank v. Minnesota	232 U.S. 516 (1914)	State of Minnesota	Property tax on obligations of U.S. territories	Tax impermissible
14. Home Savings Bank v. City of Des Moines	205 U.S. 503 (1907)	State of Iowa*	Bank shares tax on bank	Tax impermissible
15. Scottish Union & Nat'l Ins. Co. v. Bowland	196 U.S. 611 (1905)	State of Ohio*	Property tax on insurance companies' required reserves	Tax impermissible
16. Cleveland Trust Co. v. Lander	184 U.S. 111 (1902)	State of Ohio*	Bank shares tax on shareholders	Tax permissible

Name of Case	Citation	Taxing Jurisdiction	Type of Tax	Court's Determination
17. Plummer v. Coler	178 U.S. 115 (1900)	State of New York	Inheritance tax	Tax permissible
18. Home Insurance Co. v. New York	134 U.S. 594 (1890), superseding 119 U.S. 129 (1886)	State of New York	Franchise tax on capital	Tax permissible
19. Palmer v. McMahon	133 U.S. 660 (1890)	State of New York*	Bank shares tax on shareholders	Tax permissible
20. Shotwell v. Moore	129 U.S. 590 (1889)	State of Ohio*	Property tax	Tax permissible (tax avoidance)
21. Mitchell v. Board of Commissioners	91 U.S. 206 (1876)	State of Kansas*	Property tax	Tax permissible (tax avoidance)
22. Bank v. Supervisors	74 U.S. (7 Wall.) 26 (1869)	State of New York*	Tax on bank capital	Tax impermissible
23. The Banks v. The Mayor	74 U.S. (7 Wall.) 16 (1869)	State of New York*	Tax on bank capital	Tax impermissible
24. Hamilton Co. v. Massachusetts	73 U.S. (6 Wall.) 632 (1868)	State of Massachusetts	Franchise tax on capital stock	Tax permissible

Name of Case	Citation	Taxing Jurisdiction	Type of Tax	Court's Determination
25. Provident Institution v. Massachusetts	73 U.S. (6 Wall.) 611 (1868)	State of Massachusetts	Franchise tax on savings bank deposits	Tax permissible
26. Society for Savings v. Coite	73 U.S. (6 Wall.) 594 (1868)	State of Connecticut	Franchise tax on savings bank deposits	Tax permissible
27. People v. The Commissioners	71 U.S. (4 Wall.) 244 (1866)	State of New York*	Bank shares tax on shareholders	Tax permissible
28. Van Allen v. The Assessors	70 U.S. (3 Wall.) 573 (1866)	State of New York*	Bank shares tax on shareholders	Tax permissible (dictum)
29. New York *ex rel.* Bank of the Commonwealth v. Comm'rs of Taxes ("The Bank Tax Case")	69 U.S. (2 Wall.) 200 (1865)	State of New York*	Tax on bank capital	Tax impermissible
30. New York *ex rel.* Bank of Commerce v. Comm'rs of Taxes	67 U.S. (2 Black) 620 (1863)	State of New York*	Tax on bank capital	Tax impermissible
31. Weston v. City Council of Charleston	27 U.S (2 Pet.) 449 (1829)	City of Charleston	Property tax	Tax impermissible

* Statewide property taxes (in some cases, denominated bank shares or bank capital taxes) were assessed under state law by county or local tax assessors.

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No. 92-204

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1992

BANKERS TRUST NEW YORK CORPORATION AND CONSOLIDATED SUBSIDIARIES,

Petitioners,

-against-

DEPARTMENT OF FINANCE OF THE CITY OF NEW YORK AND COMMISSIONER OF FINANCE OF THE CITY OF NEW YORK,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO A PETITION FOR A WRIT OF CERTIORARI TO THE NEW YORK STATE COURT OF APPEALS

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August 27, 1992.
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COUNTER-QUESTION PRESENTED

Whether a New York City tax, imposed pursuant to State authorization, for the privilege of doing business in a corporate or organized capacity is a franchise tax or other nonproperty tax in lieu of a franchise tax, so that it meets the express exceptions to the federal tax immunity statute, Rev. Stat. §3701, 31 U.S.C. 742.

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-against-

DEPARTMENT OF FINANCE OF THE CITY OF NEW YORK AND COMMISSIONER OF FINANCE OF THE CITY OF NEW YORK,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO A PETITION FOR A WRIT OF CERTIORARI TO THE NEW YORK STATE COURT OF APPEALS

PRELIMINARY STATEMENT

Petitioners seek to have this Court review, by writ of Certiorari, an order of the New York State Court of Appeals, entered May 12, 1992, which unanimously affirmed an order of the New York State Supreme Court, Appellate Division, First Department, entered March 21, 1992. That

order unanimously confirmed the determination of the Commissioner of Finance of the City of New York, dated June 6, 1990, which determined that the City's Financial Corporation Tax is a franchise tax or, at the very least, a nonproperty tax in lieu of a franchise tax, within the meaning of Rev. Stat. §3701, 31 U.S.C. §742, and that, therefore, the City, is not precluded from including interest from federal obligations in measuring petitioner's tax liability.

STATE AND CITY LEGISLATION INVOLVED

1. Enabling Act.

(a)

New York Laws of 1966, Chapter 772, the enabling act authorizing the City to impose a Financial Corporation Tax states:

> **AN ACT to enable any city having a population of one million or more to raise tax revenue by authorizing the imposition of taxes on general, financial, insurance and transportation corporations and on unincorporated businesses *****

> Section 1. Notwithstanding any other provision of law to the contrary, any city having a population of one million or more acting through its local legislative body, is hereby authorized and empowered to adopt and amend local laws imposing for any such city taxes on general corporations, financial corporations, insurance corporations and transportation corporations. The terms of such local law or local laws shall be, substantially, as follows, except that the appendix in such local laws may be amended for the purpose of conforming it with the United States internal revenue code or other federal law relating to taxation as presently in effect or as they may be amended[.]
>
> . . .

(b)

In 1972, New York State recodified its franchise tax on banks in Tax Law Article 32 (N.Y.Laws of 1972, ch. 167). In pertinent part, it provided:

> §1451. Imposition of Tax
>
> (a) For the privilege of exercising its franchise or doing business in this state in a corporate or organized capacity ...

2. **New York City Financial Corporation Tax.**

The City was given authority to amend its tax to conform to the State law by N.Y.Laws of 1972, Chapter 874. Pursuant to that authority, the City amended the imposition clause of the City's Financial Corporation Tax to read as follows (N.Y.C. Local Law 83, 1972):

N.Y.C. Admin. Code §R46-37.1[1]

> Imposition of tax.__(a) For the privilege of doing business in the city in a corporate or organized capacity, . . .

---

[1] The New York City Administrative Code was recodified without substantive change in 1985 by Chapter 907, Laws of 1985. The Financial Corporation Tax, previously found in Title R of Chapter 46, is now found in Title 11, Chapter 6.

STATEMENT OF THE CASE

Rev. Stat. §3701, 31 U.S.C. §742, provides that obligations of the United States are to be exempt from State or municipal taxes unless the State or municipal taxes are "nondiscriminatory franchise or other nonproperty taxes in lieu thereof." New York State authorized New York City to impose a franchise tax on financial corporations for the privilege of doing business in the City in a corporate or organized capacity. The Courts below unanimously concluded that the City's tax was a franchise tax within the meaning of the federal statute, and that the interest derived by petitioners from federal obligations was properly included in the income used to measure the tax.

There is no question that this Court is not bound by a state court's characterization of a tax when a federal right is concerned. However, since the basis for the State Court's

confirmation that the City tax was a franchise tax was correctly premised on this Court's pronouncements, the instant Petition for a Writ of Certiorari should be denied.

ARGUMENT

THE DETERMINATION THAT THE CITY'S FINANCIAL CORPORATION TAX IS A FRANCHISE TAX WAS PROPER, SINCE IT FULLY COMPORTS WITH PRIOR PRONOUNCEMENTS OF THIS COURT CONCERNING WHAT CONSTITUTES A FRANCHISE TAX.

(1)

New York City's Financial Corporation Tax is imposed pursuant to State authorization "for the privilege of doing business in the City in a corporate or organized capacity".[1]

Both the nature and operation of the tax indicate that the tax is imposed for a privilege.

---

[1] Although the Model Local Law in the original enabling act did not contain the words "in a corporate or organized capacity", those words were added by Local Law 83 of 1972 pursuant to a grant of State authority (N.Y.Laws of 1972, ch. 874).

This is in distinct contrast to New York City's Unincorporated Business Tax, which was authorized by the same enabling act (N.Y.Laws of 1966, ch. 722). That tax is imposed on an unincorporated business' net income, and not on the privilege of doing business.

For over one hundred years, this Court has considered a franchise tax to be a tax imposed for, or on, a privilege. See, e.g., Colonial Pipeline Co. v. Traigle, Collector of Revenue of Louisiana, 421 U.S. 100, 102, 111-12 (1975); Memphis National Gas Co. v. Stone, Chairman, State Tax Commission, 335 U.S. 80, 85-93 (1948); Pacific Co., Ltd. v. Johnson, State Treasurer, 285 U.S. 480, 490 (1932); Home Insurance Company of New York v. New York State, 134 U.S. 594, 599 (1890); Morgan v. Louisiana, 93 U.S. (3 Otto) 217, 233 (1877).

This determination, that a franchise tax is a tax imposed for a privilege, comports with the

definitions given by numerous scholars and commentaries. See, e.g., Black's Law Dictionary at p. 593 (5th ed. 1979) (franchise tax is tax on right and privilege of carrying on business in character of a corporation (emphasis added); 71 Am. Jur.2d State and Local Taxation §266 (1973); 24 N.Y. Jur., Franchises § 1 (1962); 37 C.J.S., Franchises § 1 (1943); McQuillin, Municipal Corporations § 34.03 (3d ed. 1985); Joyce, A Treatise on Franchises, §3 (1909).

One of the criteria for differentiating a "true" franchise tax from an income tax is whether the corporation will continue to be subject to the tax despite dissolution or cessation of business within the taxing jurisdiction. Educational Films Corp. v. Ward, 282 U.S. 379, 388 (1931); Savings League of Wisconsin, Ltd. v. Wisconsin Department of Revenue, 141 Wis.2d 918, 920 (1987) appeal dismissed, 488 U.S. 806 (1988). The City Tax

applies only to banking corporations that are doing business in the City. Admin. Code §R46-37.1(a).

(2)

The genesis of Rev. Stat. §3701, 31 U.S.C. §742 (1959), is this Court's decision in McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819), wherein the Supremacy Clause of the Constitution was construed as prohibiting a tax on federal obligations. This was followed by Weston v. City Council of Charleston, 27 U.S. (2 Pet.) 449 (1829), where the Court declared that a property tax on government obligations violated both the Borrowing and Supremacy Clauses on the ground that it impeded the federal government's ability to borrow money. In 1862, the prohibition against taxing United States' obligations was codified in connection with the issuance of $150,000,000 of treasury notes to finance the Civil War. It was then provided that "all stocks, bonds, and other

securities of the United States held by individuals, corporations, or associations, within the United States, shall be exempt from taxation by or under State Authority." Act, February 25, 1862, C.33, 12 Stat. 346. But the prohibition against taxing those obligations was found not to be all-embracing. In Society for Savings v. Coite, 73 U.S. (6 Wall.) 594 (1867), this Court held that the imposition of a franchise tax passed constitutional muster, stating that "the privileges and franchises of a private corporation, and all trades and vocations by which the citizens acquire a livelihood, may be taxed by a State for the support of the State government". See also, Werner Machine Co. v. Director of Division of Taxation, 350 U.S. 492, 494 (1956); Educational Films Corp. v. Ward, supra, 282 U.S. 379, 388-389 (1931); Home Insurance Company of New York v. State of New York, supra, 134 U.S. 594, 600 (1890).

This Court has recognized that the breadth of the intergovernmental tax immunity concept has been further circumscribed since the outset of the doctrine set forth in McCulloch v. Maryland, supra, 17 U.S. (4 Wheat.) 316. In South Carolina v. Baker, 485 U.S. 505, 520 (1987), this Court recognized that modern intergovernmental immunity case law had "thoroughly repudiated" the earlier notion. It acknowledged that a tax on interest from federal obligations or on income received by a party under a government contract burdened the government because the tax burden could be passed through to the government by increasing the cost of the contract or of borrowing funds. South Carolina explicitly overruled Pollack v. Farmers' Loan & Trust Co., 157 U.S. 429 (1895). This placed the vitality of Weston v. City Council of Charelston, supra, 27 U.S. (2 Pet.) 449 in serious doubt, since Pollack was premised on

the reasoning in Weston. In South Carolina v. Baker, supra, 485 U.S. at 518, the Court stated (485 U.S. at 526):

> Indeed, this Court has in effect acknowledged that a holder of a Government bond could constitutionally be taxed on bond interest in Memphis Bank & Trust Co. v. Garner, 459 U.S. 392 (1983), which involved a state tax on federal bond interest. Although the case involved an interpretation of 31 U.S.C. §742, we premised our statutory interpretation on the observation that "[o]ur decisions have treated §742 as principally a restatement of the constitutional rule." 459 U.S., at 397. We then stated: "Where, as here, the economic but not the legal incidence of the tax falls upon the Federal Government, such a tax generally does not violate the constitutional immunity if it does not discriminate against holders of federal property or those with whom the Federal Government deals." Ibid. (emphasis added).

The legal incidence of the City tax is not on the Federal Government nor is it discriminatory. The intergovernmental tax immunity doctrine is not compromised by the City's imposition, pursuant to State authorization, of a franchise tax which includes

in its measurement base interest from federal obligations.

(3)

The fact that the City, on its own, has no power to grant the corporate franchise does not preclude the State from delegating the right to tax the franchise to the City. Nor is it improper for the State to impose two franchise taxes. Just as it has the power to impose a franchise tax at double the amount of the existing one, it can impose both the existing tax and in addition thereto a separate tax in the same amount. Both taxes could apply to the entire State or one could be applied only to a limited geographical portion. North v. Russell, 427 U.S. 328, 338-339 (1976); Salsburg v. Maryland 346 U.S. 545, 550-554 (1954); Missouri v. Lewis, 101 U.S. (11 Otto) 22, 29-31 (1879).

Cities are political subdivisions of a state created, inter alia, as agencies for the exercise

of such governmental powers and functions of the state as may be entrusted to them. United States v. Wheeler, 435 U.S. 313, 320-21 (1978); City of Trenton v. State of New Jersey, 262 U.S. 182, 185-86 (1923). Whether the City rather than the State is the actual grantor of the franchise "to be" is irrelevant since it grants the privilege "to do" business in the City. The franchise "to do" is a franchise separate and apart from the franchise "to be". Joyce, A Treatise on Franchises, §39 at pp. 102-3 (1909).

The decision of the Court below correctly followed precedent established by this Court.

CONCLUSION

THE PETITION FOR A WRIT OF CERTIORARI SHOULD BE DENIED.

August 27, 1992.

Respectfully submitted,

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DEPARTMENT OF FINANCE OF THE CITY OF NEW YORK AND COMMISSIONER OF FINANCE OF THE CITY OF NEW YORK,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

PETITIONERS' REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

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COURT OF APPEALS OF THE STATE OF NEW YORK

PETITIONERS' REPLY TO RESPONDENTS' BRIEF IN OPPOSITION

ARGUMENT

THE DECISION BELOW DOES NOT COMPORT WITH PRIOR PRONOUNCEMENTS OF THIS COURT

The sole argument advanced by respondents to support their opposition to the grant of the Petition is that the state court's determination that the City financial corporation tax is a franchise tax was proper "since it fully comports with prior pronouncements of this Court concerning what constitutes a

Note: The list of companies required by Rule 29.1 is included in the footnote on page ii of the Petition and is currently accurate.

franchise tax." This argument, however, incorrectly characterizes the prior pronouncements of this Court.

Not one of the Supreme Court (or other) cases cited by respondents deals with the treatment of a municipal tax as a franchise tax. Rather, respondents seek support from general definitions of *state* "franchise taxes" as taxes imposed on a privilege. And since the City tax ordinance, begins with the language "for the privilege of doing business in the city in a corporate or organized capacity . . . ,"[1] respondents contend that the City tax falls within the definition. In effect, respondents (and the court below) are asserting that it makes no difference whether the tax is a state tax or a city tax, as long as it contains the privilege language. This assertion is doubly flawed.

First, even during the heyday of the special distinction accorded by this Court to franchise taxes, the Court never grounded this distinction merely on the inclusion in a taxing statute of language referring to "privilege." Rather, the Court's concept was that a franchise tax was a charge for a valuable benefit relating to the corporate status conferred in the discretion of the state.[2] Since a city has no power or authority to confer such a benefit, its tax cannot fall within this rationale, regardless of the prefatory privilege language. In this connection, it is emphasized that petitioners are not differentiating between the grant of a franchise "to be" a corporation and the grant of authority "to do" business (in exercise of the franchise).[3] The city has power over neither the grant nor the con-

---

1 There is a dispute between petitioners and respondents over the City's authority under state law to include the last six words, "in a corporate or organized capacity." *Compare* Pet., p. 11, n.6 *with* Br. in Opp., pp. 4 and 6, n.1. Further discussion of this point is reserved for petitioners' brief should the Court grant certiorari.

2 *E.g.*, see *Colonial Pipeline Co.* v. *Traigle*, 421 U.S. 100, 109, 111-112 (1975); *Werner Machine Co.* v. *Director of Taxation*, 350 U.S. 492, 493 (1956). Moreover, these and all the other cases cited by respondents involved state taxes.

3 It has been suggested, however, in at least one Supreme Court opinion that for purposes of exception from § 3701, there is a difference. See

tinued exercise of the corporate franchise. This is not to say that the City has no authority to tax corporations, but only that such tax is not a franchise tax.

Second, and perhaps more significant in the context of Rev. Stat. § 3701, an expansive definition of franchise tax as including any purported privilege tax (without regard to the taxing authority's right to grant the privilege) is inconsistent with the language and purpose of the 1959 amendment to Rev. Stat. § 3701. As this Court stated in reference to Rev. Stat. § 3701, as amended in 1959, "The language of § 3701 encompasses 'every form of taxation,' and is inconsistent with implied exceptions." *American Bank & Trust Co.* v. *Dallas Co.*, 463 U.S. 855, 864, reh'g den., 463 U.S. 1250 (1983). The Court there rejected a plea for continuation of the old case-law exception for a bank shares tax which, before 1959, had been treated the same as a franchise tax under § 3701. Likewise, the expansion of the definition of "franchise tax" to include city as well as state taxes is unwarranted. Under the amended language of Rev. Stat. § 3701, the only way a corporate tax other than a franchise tax can qualify for exception is if it is "in lieu of" or "instead of" a franchise tax. An expansive definition of "franchise tax" would emasculate the in-lieu requirement, at least in a case such as the present one where the City tax is clearly in addition to, and not in lieu of, a state franchise tax. In addition, § 3701 excepts franchise taxes "imposed on corporations," indicating that the exception was for the traditional state corporate franchise tax, and not for other "privilege" taxes which could just as easily be imposed on noncorporate businesses[4] as well as corporations.

Home Ins. Co. v. *New York*, 134 U.S. 594, 599 (1890) ("By the term 'corporate franchise or business,' as here used, we understand is meant . . . the right or privilege given by the State to two or more persons of being a corporation, that is, of doing business in a corporate capacity, and not the privilege or franchise which, when incorporated, the company may exercise.")

4 The state enabling act in the present case authorized "the imposition of taxes on general, financial, insurance and transportation corporations and on unincorporated businesses . . . ." See Br. in Opp., p. 2.

This Court, in the *American Bank* case, summarized the purpose of the 1959 amendment to § 3701 as follows:

> "Congress intended to sweep away formal distinctions and to invalidate all taxes measured directly or indirectly by the value of federal obligations, except those specified in the amendment." 463 U.S. at 867.

It would hardly effectuate this purpose now to expand the formalistic exception for state franchise taxes to include other "privilege" taxes which had never been held to be excepted under the pre-1959 law.

CONCLUSION

This Court should grant the Petition for Writ of Certiorari and review the decision of the New York Court of Appeals.

Respectfully submitted,

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